

HONDURAS

POVERTY REDUCTION AND LOCAL DEVELOPMENT PROGRAM PHASE II

(HO-0220)

EVALUATION REPORT

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BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

[HTTP://WWW.IADB.ORG/RES/INDEX.CFM?FUSEACTION=EXTERNALLINKS.COUNTRYDATA](http://www.iadb.org/res/index.cfm?fuseaction=externallinks.countrydata)
[C](#)

ABBREVIATIONS

AMHON	Asociación de Municipios de Honduras [Association of Honduran Municipalities]
AWP	Annual work plan
CEDE	Comisión Ejecutiva para la Descentralización del Estado [Executive Commission for Decentralization of the State]
CONCAM	Comité Nacional de Capacitación y Asistencia Técnica Municipal [National Committee on Municipal Training and Technical Assistance]
CTA	Chief technical advisor
DOPC	Operational delegation of the project cycle
ESA	Economía, Sociedad y Ambiente Consultores
FHIS	Fondo Hondureño de Inversión Social [Honduran Social Investment Fund]
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit [German Agency for Technical Cooperation]
INE	Instituto Nacional de Estadísticas [National Statistics Institute]
KfW	Kreditanstalt für Wiederaufbau
MTAO	Municipal Technical Administrative Office
MTR	Midterm review
NGO	Nongovernmental organization
OR	Operating Regulations
PATMUNI	Plan de asistencia técnica municipal [municipal technical assistance plan]
PISM	Plan de inversión social municipal [municipal social investment plan]
PRODDEL	Programa de Descentralización y Desarrollo Local [Decentralization and Local Development Program]
PRS	Poverty Reduction Strategy
SEFIN	Secretaría de Finanzas [Ministry of Finance]
SGJ	Secretaría de Gobernación y Justicia [Ministry of the Interior and Justice]
SIAF	Sistema Integrado de Administración Financiera [Integrated Financial Management System]
SINIMUN	Sistema de Información Municipal [Municipal Information System]
STP	Secretaría Técnica de la Presidencia [Technical Secretariat of the Office of the President]
TOR	Terms of reference
UAT	Unidad de Apoyo Técnico [DOPC Technical Support Unit]
UTD	Unidad Técnica de Descentralización [Technical Unit for Decentralization]



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Honduras

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
HO0205	Sula Valley Citizenship Security	20.0	APPROVED
HO0221	Program to Foster Business Competitiveness	10.0	APPROVED
HO0220	Poverty Alleviation and Local Dev. phase II	35.0	
HO0212	Poverty Reduction Sector Program	30.0	
HO0219	Financial Sector Program	25.0	
HO0218	Pro-Bosque Program	20.0	
HO0208	Strengthening of Fiscal Management	15.0	
HO0202	Vocational and Technical Education Program	30.6	
Total - A : 8 Projects		185.6	
HO0197	Poverty Reduction Program focusing on Indigenous peoples and Afro descendants	10.0	
Total - B : 1 Projects		10.0	
TOTAL 2003 : 9 Projects		195.6	

2004

Project Number	Project Name	IDB US\$ Millions	Status
HO0226	Turism for Mundo Maya Circuit	5.0	
HO0207	Roads Rehab and Sustainability Fase I	50.0	
HO0224	Electric transmission and suministration program	30.0	
Total - A : 3 Projects		85.0	
HO0195	Coast Marines Enviromental Systems Management	20.0	
HO0222	Social Protection Program	30.0	
RG0059	Etnoturísticos Mesoamericanos Fund Projects	30.0	
Total - B : 3 Projects		80.0	
TOTAL - 2004 : 6 Projects		165.0	
Total Private Sector 2003 - 2004		0.0	
Total Regular Program 2003 - 2004		360.6	

* Private Sector Project



HONDURAS

IDB LOANS

APPROVED AS OF JULY 31, 2003

	US\$Thousand	Percent
TOTAL APPROVED	2,344,473	
DISBURSED	1,913,832	81.63 %
UNDISBURSED BALANCE	430,641	18.36 %
CANCELATIONS	164,274	7.00 %
PRINCIPAL COLLECTED	674,618	28.77 %
APPROVED BY FUND		
ORDINARY CAPITAL	537,452	22.92 %
FUND FOR SPECIAL OPERATIONS	1,737,387	74.10 %
OTHER FUNDS	69,633	2.97 %
OUTSTANDING DEBT BALANCE	1,239,214	
ORDINARY CAPITAL	169,966	13.71 %
FUND FOR SPECIAL OPERATIONS	1,068,977	86.26 %
OTHER FUNDS	272	0.02 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	294,711	12.57 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	72,751	3.10 %
ENERGY	413,750	17.64 %
TRANSPORTATION AND COMMUNICATIONS	400,396	17.07 %
EDUCATION	71,293	3.04 %
HEALTH AND SANITATION	260,118	11.09 %
ENVIRONMENT	80,092	3.41 %
URBAN DEVELOPMENT	153,452	6.54 %
SOCIAL INVESTMENT AND MICROENTERPRISE	329,283	14.04 %
REFORM AND PUBLIC SECTOR MODERNIZATION	235,411	10.04 %
EXPORT FINANCING	6,908	0.29 %
PREINVESTMENT AND OTHER	26,308	1.12 %

* Net of cancellations with monetary adjustments and export financing loan collections.



HONDURAS

STATUS OF LOANS IN EXECUTION AS OF JULY 31, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Before 1997	4	53,900	41,398	76.81 %
1997 - 1998	6	172,106	92,699	53.86 %
1999 - 2000	12	206,049	69,554	33.76 %
2001 - 2002	15	179,676	18,173	10.11 %
2003	2	30,000	0	0.00 %
<u>PRIVATE SECTOR</u>				
2001 - 2002	1	13,700	0	0.00 %
TOTAL	40	\$655,431	\$221,824	33.84 %

* Net of cancellations. Excludes export financing loans.

POVERTY REDUCTION AND LOCAL DEVELOPMENT PROGRAM, PHASE II

(HO-0220)

EXECUTIVE SUMMARY

Borrower:	Republic of Honduras	
Executing agency:	Honduran Social Investment Fund (FHIS) and Ministry of the Interior and Justice (SGJ)	
	Phase II	
Amount and source:	IDB (FSO):	US\$35.0 million
	Borrower:	US\$ 3.9 million
	Total:	US\$38.9 million
Financial terms and conditions:	Amortization period:	40 years
	Grace period:	10 years
	Commitment period:	3.5 years
	Disbursement period:	Minimum: 3 years Maximum: 4 years
	Interest rate:	1% per annum during first 10 years, and 2% thereafter
	Inspection and supervision:	1% of the total loan
	Credit fee:	0.5% per annum on the undisbursed balance
Background:	<p>The Bank's Board of Executive Directors approved the Honduras poverty reduction and local development program (1068/SF-HO) on 7 November 2000 (see Annex I for the executive summary of loan proposal PR-2528). The program is a multiphase loan under the Flexible Lending Instruments framework (GN-2085-2) with an estimated total cost of US\$66.7 million (US\$60 million to be financed by the Bank), divided into two phases of US\$25 million and US\$35 million, respectively. Phase I is currently under way.</p>	
Program and phase I objectives:	<p>The program's goal is to support implementation of the poverty reduction strategy (PRS) in Honduras, its general objective being to help improve the living conditions of the poor by providing greater access to basic social services with community participation. The specific objectives of Phase I were: (i) to carry out the projects selected in the 1998 municipal social investment plans (PISMs), awaiting financing due to the backlog caused by Hurricane Mitch;</p>	

(ii) to pilot programs to strengthen local communities; and (iii) to support FHIS participation in the PRS as a key poverty reduction instrument.

**Phase I
evaluation
findings,
targets set and
met:**

Phase I set 34 targets cutting across the key components of the program, to gauge how the FHIS has adjusted to better meet the needs of poor communities in Honduras. These indicators sought to determine the number of projects financed under the PISMs, community participation and interest level, beneficiary satisfaction, local commitment to works maintenance, and other factors. The phase I evaluation findings show that most of the targets have been met (see Table I.1). Especially noteworthy are the success of the participatory planning pilot and efforts to enhance the social and environmental qualifications of FHIS staff. To date, 66% of phase I resources have been disbursed, and 86% committed. While the phase I evaluation shows where room remains for improvement, the gains and strides that have been made, especially in the pilot projects to strengthen local communities, clearly point the way for future strategic progress. Of special note are the FHIS's new approach, willingness to learn from the pilot projects, commitment to reach out to the poor, and desire to play a key role in the PRS and the decentralization and local development process.

**Phase II
objective and
description:**

Phase II maintains the same general program objectives and builds on lessons learned from phase I, taking a more comprehensive approach to poverty and local development. It also draws on the new government policy, adding the SGJ as co-executing agency with the task of coordinating, monitoring, and establishing rules to govern the decentralization and local development process. The FHIS's role is as a source of social investment.

Phase II will extend the key phase I components—shifting their emphasis in some instances—to help create a policy framework for municipal and local development, and leverage FHIS/SGJ synergies in the area of poverty reduction. The specific components and objectives will be: (i) **investment in social infrastructure**, funding social projects identified and priority ranked through participatory planning processes, and transferring responsibilities to communities and municipios with the interest and capacity; (ii) **municipal and local management**, building the financial and institutional capacity of municipal governments, so they can better meet the needs articulated by the local population; and (iii) **strengthening the institutional framework**, supporting reforms at the FHIS and SGJ, so they can fulfill their role in the PRS and the decentralization and local development program. The implementation arrangement is tailored to the capacity and responsibilities of each institution.

Program's role in the Bank's country and sector strategy:

The Bank's country strategy with Honduras gives high priority to poverty reduction through processes that foster economic growth and strengthen the management capacity of the poor. The program supports the country strategy by financing activities to: (i) meet Hondurans' basic needs in the area of social services; (ii) strengthen local capacity and management; and (iii) improve governance with an emphasis on citizen participation and social audits.

The program is in line with the Bank's operating guidelines on social investment funds and decentralization. The operation gives communities and municipios a leading role; focuses on effective decentralization of responsibility for social service delivery; promotes institutional coordination among local development activities; and provides incentives for sharing responsibility and coordinating with local governments.

Coordination with other official development agencies:

Phase I was part of a US\$135 million global program. Especially noteworthy has been the interagency coordination among the World Bank, Kreditanstalt für Wiederaufbau (KfW), and IDB on the design and execution of FHIS-funded activities. Generally speaking, the FHIS programs financed by these institutions are designed as part of a joint effort to pursue the same purposes within a global framework. This interagency coordination will continue in phase II, which has been prepared in a context of ongoing dialogue with the World Bank, KfW, and the foreign cooperation office in Honduras (paragraph 1.9).

Environmental and social review:

The FHIS project cycle requires an environmental assessment of all projects prior to approval. Standard projects (education and health) are checked to see whether the criteria included in the prototypes are provided for and/or satisfied. In all other projects, an environmental diagnostic assessment and/or environmental impact assessments are conducted, as appropriate. The municipal training to be delivered by the SGJ will include an environmental management module, to encourage sustainable natural resource management and environmental protection.

Consideration of gender and ethnic issues is a basic feature of the municipal participatory planning method. Evaluation of the pilot showed that incentives to encourage equitable inclusion of women were one of the wisest decisions of the participatory planning experiment.

Benefits:

The program will contribute broadly to the poverty reduction efforts of the Government of Honduras, giving the poor greater access to social services by funding US\$22 million in small-scale social projects in the education, health, water, sanitation, and road

construction sectors. Specifically, it will support expanded service coverage in early childhood and primary education, primary and preventive health care, water, and basic sanitation in rural areas.

Greater access to social services is expected to improve living conditions locally by raising school enrollment and attainment levels, increasing the use of primary health care services, expanding vaccination coverage, and lowering the incidence of diarrhea in the targeted areas.

All funded projects must be part of a municipal investment plan, arrived at through a democratic participatory process. The planning methodology fosters broad participation of groups and communities traditionally excluded from government decision-making, such as indigenous and Afro-descended groups. It also encourages freedom of expression, to make sure that the program funds projects that have been assigned high priority at the local level. Training local community leaders to organize participatory planning meetings and serve as delegates to regional assemblies and community meetings stimulates local leadership.

Delegation of the FHIS project cycle and SGJ-sponsored ancillary activities will better position municipal governments to meet the needs articulated by the local population. The program will support municipios in project design, evaluation, contracting, execution, and supervision with the goals of building municipal technical and management capacity, making municipios more autonomous, and empowering them through technical assistance activities in municipal finance and administration, modernization of local public utilities, environmental management, local governance and transparency, and land-use planning.

Risks:

The SGJ activities under the program carry risks associated with management and politics. The management risks relate to the SGJ's limited experience executing projects of this kind and the need for a stronger Technical Unit for Decentralization (UTD). This risk will be mitigated by hiring a project management firm for all SGJ activities under the loan, and setting up a management unit within the UTD, staffed with three specialist consultants.

The political risks relate to the decentralization process, whose continued success depends both on government leadership and on how civil society receives it. Since sustainable decentralization entails new policies and a new relationship to civil society, the program will include a public relations and marketing plan to stimulate broad-based national dialogue.

Special contractual clauses:	<p>Conditions precedent to disbursement of component 1, (investment in social infrastructure) and component 3(1) (modernization of the FHIS). The FHIS must present evidence acceptable to the Bank that: (i) the FHIS and Ministry of Finance have entered into an agreement for the transfer of resources; (ii) a chief technical advisor has been hired to oversee all consulting assignments associated with modernization of the FHIS; (iii) the program Operating Regulations (FHIS) are in effect; (iv) the framework agreements with the Ministry of Education, Ministry of Health, and the Ministry of Natural Resources and the Environment have been updated.</p> <p>Conditions precedent to disbursement of component 2 (municipal and local management) and component 3(2) (strengthening the SGJ and policy framework). The SGJ must present evidence acceptable to the Bank that: (i) a project management firm has been hired to execute the SGJ activities; (ii) the SGJ/municipio framework agreements have been approved for the municipal technical assistance program and Innovation Program; and (iii) the program Operating Regulations (SGJ) are in effect.</p>
Special terms and conditions for execution:	<p>The special terms and conditions for execution are: (i) submission of an annual work plan (paragraph 3.38); (ii) midterm review and final evaluation (paragraph 3.22 to 3.26); (iii) submission of baseline data (paragraph 3.27); and (iv) contingent disbursement of more than 30% of component 1 resources (investment in social infrastructure) (paragraph 3.30)</p>
Poverty-targeting and social equity classification:	<p>This operation qualifies as a social equity enhancing program, as described in the indicative targets for the Bank's activities set out in the Bank's Eighth General Increase in Resources (AB-1704). Furthermore, this operation qualifies as a poverty-targeted investment (PTI) (paragraph 4.17).</p>
Partial disbursement of resources:	<p>The project team recommends disbursing up to US\$200,000 for the SGJ to move ahead with the technical activities necessary for execution of program component 2, subject to fulfillment of the conditions precedent to the first disbursement as stated in the general conditions of the loan contract (paragraph 3.37).</p>
Exceptions to Bank policy:	<p>None.</p>
Procurement:	<p>Procurement of works, goods, and consulting or other related services will conform to Bank policies and procedures. International competitive bidding will be required for construction contracts with an estimated cost of US\$1.5 million equivalent or more, US\$250,000</p>

equivalent or more for goods, and over US\$200,000 equivalent for consulting services. Procurement of works, goods, and services that fall below such thresholds will be governed by Honduran legislation.

I. POVERTY REDUCTION AND LOCAL DEVELOPMENT PROGRAM

A. Background

- 1.1 The Bank's Board of Executive Directors approved the Honduras poverty reduction and local development program (1068/SF-HO) on 7 November 2000 (see Annex I for the executive summary of loan proposal PR-2528). The program's goal was to support implementation of the poverty reduction strategy (PRS), giving local stakeholders a greater role in local development processes. The Bank conceived and developed the program as a multiphase loan with an estimated total cost of US\$66.7 million (US\$60 million to be financed by the Bank), divided into two phases of US\$25 million and US\$35 million, respectively. Phase I is currently under way. The grounds for a multiphase approach were that the program's success depends upon sustained effort over an extended period of time, and that the formulas being experimented with and evaluated were more decentralized than usual in Honduras.
- 1.2 As agreed with the Government of Honduras, financing of Phase II of the program is contingent upon a positive evaluation of Phase I and the attainment of targets denoted by indicators. The evaluation was to assess program execution and determine how well the general objectives of the program were being met, focusing on the quality of the works, supervision during the construction stage, compliance with environmental requirements, social audits, and the preparation of works maintenance plans. The outcomes of the participatory planning pilot projects were also to be evaluated, as were maintenance of works and operational delegation of the project cycle to the municipalities. Phase II would then incorporate the evaluation findings and lessons learned.
- 1.3 This report will: (i) investigate the attainment of phase II triggers; (ii) summarize the phase I evaluation findings; and (iii) present for approval by the Board of Executive Directors a proposal for a loan of up to US\$35 million under phase II of the poverty reduction and local development program.

B. The program's relationship to the Bank's and country's strategy

- 1.4 The Bank's country strategy with Honduras is geared to poverty reduction, in line with the PRS prepared by that country with Bank assistance. The program dovetails with one of the main PRS objectives of creating social safety nets for groups living in extreme poverty. The Bank's country strategy also supports the government's priority efforts to invest in basic social services and better target resources to the neediest people. The program is one of several now under way to develop, use, and update targeting tools with broad community participation. Two other examples of targeting and community participation are the family allowance program (1026/SF-HO) and the program for reforming the institutional framework and creating instruments for implementing the PRS (1087/SF-HO).

C. Program phase I and evaluation

- 1.5 This program is in line with the PRS, its general objective being to help improve the living conditions of the poor by providing greater access to basic social services with community participation. The program emphasizes and promotes active local stakeholder participation in the investment cycle as a way of fostering community empowerment and a sense of community ownership of service delivery, thereby ensuring more effective and sustainable interventions.
- 1.6 **Phase I.** The specific objectives of Phase I were: (i) social investment to finance small construction projects that have been identified and assigned high priority through participatory planning processes; (ii) pilot programs to strengthen local communities and experiment with new forms of planning, operational delegation of the project cycle, and preventive maintenance; and (iii) institutional strengthening activities to help the Honduran Social Investment Fund (FHIS) establish itself in its new role.
- 1.7 The bulk of phase I program resources went to finance social projects on which construction had stalled in the wake of Hurricane Mitch. These projects had been identified and assigned high priority under the 1998 municipal social investment plans (PISMs), but were set aside in order to attend to more pressing needs. To meet community expectations, the program financed construction of the PISM projects, to which improvements were made as needed with private support. These projects were in the education, health, water, sewerage, municipal services, and environment sectors. The “menu” of 40 different kinds of construction projects identified as targeting the needs of the poor included the repair, expansion, and building of schools and health facilities, overhauling and cleaning wells, and building latrines. Consequently, the menu went a long way toward self-selecting for the poorest segments of the population and minimized chances of resources being diverted to better-off groups.
- 1.8 The pilot programs to strengthen local communities sought to enhance the managerial capabilities of municipios and communities. In 2001 a participatory planning experiment was conducted in 30 municipios, to select and rank social projects. Municipal authorities worked with communities to identify issues, weigh options, and rank problems to be addressed in order of priority. The methodology was designed to ensure transparency, inclusiveness, community participation, sustainability, and targeting of resources to the poorest of the poor. The pilot project currently under way on operational delegation of the project cycle (DOPC) transfers to municipios that meet institutional and financial eligibility requirements such project-cycle activities as: (i) project identification; (ii) project development and evaluation; (iii) contracting; (iv) project execution; (v) project closure; and (vi) preventive maintenance of works. Experimentation with preventive maintenance during project execution as well was intended to fine-tune maintenance arrangements on standard construction projects. The pilot project

supported the repair and maintenance of works, financed technical assistance for changes to training manuals, and helped set up oversight mechanisms.

- 1.9 Phase I was part of a US\$135 million global program. Of the 6,888 FHIS-executed projects in 2000-2002, 71% of the investment targeted education, health, water, and sewerage. These projects benefited 2.1 million people, the vast majority of them in poor, rural areas. Especially noteworthy has been the interagency coordination among the World Bank, Kreditanstalt für Wiederaufbau (KfW), and IDB on the design and execution of FHIS-funded activities. Generally speaking, the FHIS programs financed by these institutions are designed as part of a joint effort to pursue the same purposes within a global framework.

D. Phase I indicators

- 1.10 To evaluate phase I, performance and process indicators were used along with qualitative assessments. Thirty-four targets were set across the three main program components, to measure changes at FHIS to better meet the needs of Honduras's poor communities. The findings of the evaluation by a local consulting firm indicate that 68% of the phase II trigger indicators have been met so far. In some instances, such as the DOPC pilot project, it is still too early to judge whether a number of targets have been met. Table I.1 below shows the targets and the extent to which they have been met.

Table I.1
Phase II Trigger Indicators

	TARGET	ACTUAL
I. Component 1. Social infrastructure investment commitments		
1. Amount of component 1 /phase I funding allotted to executing backlog projects (1998 PISM)	Disbursed = 50% Committed = 70%	61.5% 85.8 %
2. % of municipalities that, having opted to update their PISMs, actually did so.	= 95%	100%
3. % of projects with works maintenance organizations (ORMs) and social auditors established	= 80%	69%
4. % of C and D category municipalities receiving training and a basic maintenance toolkit	= 90%	91.6%
5. % of direct beneficiaries and % of project amounts contracted for in areas of rural poverty	See note below	Yes
6. % of all projects completed with quality at or above the norm	= 90%	80%
7. % of completed projects satisfying environmental requirements	= 95%	tbd
8. Beneficiary satisfaction (on a scale of 1 to 5)	Rating = 3	4
II. Component 2. Pilot projects to strengthen local communities		
a. Participatory planning pilot project		
1. % of participating municipalities with a tested PP methodology and new PISM	= 90%	100%
2. % of communities by municipality that are participating in PP processes	= 80%	95%
3. % of assemblies that have used the prioritization matrix	= 80%	100%
4. % of direct beneficiaries and % of project amounts contracted for in areas of rural poverty	See note below	Yes
5. Beneficiary satisfaction (on a scale of 1 to 5)	Rating = 3	4
b. Preventive maintenance pilot project		
1. % of new projects with technology transfer through training and technical assistance	= 90%	20.7%
2. % of FHIS projects built since 1998 in the participating municipalities with preventive maintenance plans	= 60%	76%
3. % of poor municipios (categories C and D) in the pilot project receiving financial support for maintenance	= 100%	Yes
4. FHIS-municipalities mechanism to monitor or verify maintenance is operational	12 months into the program	Yes
5. Beneficiary satisfaction (on a scale of 1 to 5)	Rating = 3	Inteterminate
c. DOPC pilot project		
1. % of municipalities taking part in the pilot project that have arranged contracts for 30% of the municipal allocation	= 90%	7%
2. % of delegated projects with complete documentation files	= 95%	82%
3. % of delegated projects completed on schedule	= 50%	Inteterminate
4. % of municipalities taking part in the pilot project that set up municipal administrative technical offices (MTAOs) supporting the DOPC	= 90%	100%
5. % of municipalities taking part in the pilot project that participate in training and technical assistance	= 90%	100%
6. % of all projects completed with quality at or above the norm	= 90%	Inteterminate
7. % of municipalities with municipal environmental units (UAMs) set up	= 90%	100%
8. % of completed projects satisfying environmental requirements	= 90%	100%
9. % of municipalities with rigorous accounting and financial control system in place for FHIS projects	= 90%	100%
10. Ratio of unit costs for delegated standard projects and non-delegated projects	= 1	Yes
11. Beneficiary satisfaction (on a scale of 1 to 5)	Rating = 3	2
III. Component 3. Institution-strengthening		
1. FHIS's operating and administrative manuals adjusted and updated in accordance with its new functions	During program year 1	No
2. % of human resources in municipal strengthening, projects, and supervision and monitoring departments with enhanced social and environmental qualifications	= 80%	100%
3. Technical support unit set up to manage DOPC	During program year 1	Yes
4. Human resource management system up and running	During program year 1	Yes
5. Plan to strengthen the FHIS, so it can assume its new role as described in the PRS	In program year 2	Yes

Note: Percentages must be higher than rural area population percentages.

E. Execution and targets met

1.11 The table shows that FHIS has met the majority of targets associated with its objective of working more closely with the communities and municipios of

Honduras. While the phase I evaluation shows where room remains for improvement, the gains and strides that have been made, especially in the pilot projects to strengthen local communities, clearly point the way for future strategic progress. Of special note are the FHIS's new approach, willingness to learn from the pilot projects, commitment to reach out to the poor, and desire to play a key role in the PRS and the process of decentralization and local development. Building on the lessons learned, phase II will support the expansion of institutional strengthening pilot projects and make the necessary adjustments to increase the long-term impact of its projects. The phase I outcomes and lessons learned (2001-2003) are discussed in greater detail below.

- 1.12 The phase I loan was declared eligible for disbursements on 30 April 2001. To date, 66% of the US\$25 million in loan proceeds have been disbursed, and 86% committed. The remaining US\$8.4 million are expected to be disbursed by February 2004.

**1. Component 1. Social infrastructure investment commitments
(US\$24.2 million)**

- 1.13 All municipios amended their PISMs, some more than once in response to shifting priorities. More than 50% of the projects identified and assigned high priority in the PISMs were executed for a total of 1,239 social projects. Most in demand were projects to repair, expand, and build schools and health facilities. Construction work complied with technical specifications, and high-quality materials were used. The basic social infrastructure projects targeted mainly the rural poor; fewer than 20% of projects were in city centers.

**2. Component 2. Pilot programs to strengthen local communities
(US\$900,000)**

- 1.14 **Participatory planning.** The participatory planning pilot project achieved its goals for transparency, inclusiveness, community participation, and targeting of resources. Of participants interviewed, 100% called it a praiseworthy effort for incorporating community views into the PISMs and making a concerted effort to involve nearly all communities. Even so, despite the more inclusive approach of the participatory planning methodology, the municipios saw the planning exercise more as a stepping-stone to FHIS financing than an effective development tool. One recommendation, then, is that the process have the stated support of other stakeholders, such as the Ministry of the Interior and Justice (SGJ) and the Association of Honduran Municipalities (AMHON), given their important role in local development.

- 1.15 **Preventive maintenance.** While not yet complete, this pilot project is showing promise.¹ Some 76% of municipalities now have maintenance plans for FHIS works, developed with assistance from NGOs and project builders. Works in a number of municipios are in good condition after cleaning, painting, and having sheeting replaced and doors and locks repaired. To build on what the pilot project has achieved, a mechanism is in place to verify that communities honor their commitment to maintain model works (schools and health facilities). The main recommendation is to institutionalize a strategy for the mass adoption of preventive maintenance practices, leading to future cost savings for the public sector.
- 1.16 **Operational delegation of the project cycle.** Twenty-one of Honduras's strongest municipios and a league of seven others took part in pilot projects on operational delegation of the project cycle. Currently, 53% of the DOPC pilots are in execution, 40% are at the contracting stage, 5% are in development, and 2% are complete.² All are expected to be complete by February 2004. The municipios have received technical advice on competitive bidding processes and contracting, contractor certification, supervision and monitoring, project design, and environmental issues. All municipios have set up a Municipal Technical Administrative Office (MTAO) to support the DOPC with a resident engineer, systems operator, and general administrator. The project cycle as adapted to the municipalities' needs has been well understood, and technical staff appear to be administering it without serious problems. The majority of projects evaluated in the field (82%) have complete and up-to-date documentation files.
- 1.17 The main bottleneck so far involves the transfer of funds to the municipios. Initially, FHIS paid contractors directly. The recommendation was that FHIS disburse the total amount of the project cost into the municipio bank accounts for the municipio to manage directly.
- 1.18 While the outcomes of some projects are encouraging, the small number of completed projects means that no clear inferences can be drawn as to the quality of the finished works or execution time. These indicators will have to be examined once the pilot is complete, so the recommendation is for continued gradual expansion, first to the strongest municipios and using a simpler model. This will help adapt, build on, and strengthen the methodology as the FHIS adjusts to more effectively support and advance the process.

3. Component 3. Institutional strengthening of the FHIS (US\$400,000)

- 1.19 The FHIS has made great strides on the institutional front during phase I, building in environmental and training capability as a permanent feature by setting up specialized units, and providing in-house training to enhance the social qualifications of its staff. The human resources management system was another

¹ This pilot project began execution at the time the new administration took office in early 2002.

² Idem.

accomplishment, providing a continually upgraded set of basic functions, some of them automated. The successful DOPC Technical Support Unit (UAT) is pointing the way for the FHIS in coming years.

- 1.20 A recent study reveals a weakening of the FHIS in recent years with the emergency and government changeovers, eroding its ability to efficiently and effectively meet its long-standing commitments to social investment. Consequently, the FHIS should restructure its operations, including a technology development plan to improve its systems. An international consultant should be hired as chief technical advisor to oversee restructuring and support agency coordination. A further recommendation is to do away with the existing short-term staff recruitment procedures in favor of a system that lowers the risk of constant turnover in professional staff.

F. Lessons learned

- 1.21 Delegation of a complex process like the FHIS project cycle demands substantial effort from all involved. A simpler project cycle and procedures would be easier for the municipios and FHIS to administer. Project cycle delegation processes are strengthened by continuing education and training to the municipios and FHIS. Another lesson is that smooth integration of the MTAO and municipios will mean incorporating MTAO functions into the municipios' technical and environmental divisions, tightly interweaving operational delegation of the project cycle into the management of all municipal projects.
- 1.22 The priority ranking of projects as part of the municipal participatory planning process was seen as a transparent and fair, even though it did not benefit all communities (those whose projects were not assigned high priority in the municipal planning process). The voting system and such enabling instruments as the talking map and prioritization matrix were decisive in participants' perception of the process as transparent.
- 1.23 All mayors and local leaders agreed that the inclusion of women was one of the great successes of the participatory planning experiment. In fact, women tended to participate more than men at the community meeting level, especially when the projects at issue involved education and health. However, there were some instances of communities selecting no women to represent them at the next level, the regional assembly. The rules will be tightened in phase II, to ensure that women are represented at all regional assemblies. All in all, while there is always room for improvement, promoting gender equity may have made participants more aware of, and sensitive to, the importance of women becoming more visibly involved in community decision-making.
- 1.24 The preventive maintenance pilot revealed the need for a cofinancing and execution arrangement to raise additional local resources from the central government, the

municipios, communities, and the private sector, as well as to encourage a new culture among citizens in regard to the maintenance of works.

- 1.25 The relaxation of procedures in order to respond to such emergencies as Hurricane Mitch and frequent government changeovers has weakened the FHIS as an institution. Specifically, the succession of administrations has undermined its organizational/functional structure, information system, managerial control, and operational effectiveness.

G. Phase II rationale and conclusions

1. The role of local participation and decentralization in the PRS

- 1.26 The March 2003 PRS preliminary progress report and update reaffirmed the Honduran's government's commitment to poverty reduction as a main focus of the country's economic and development strategy. It also emphasized the need for further decentralization to support efficient and transparent execution of PRS programs and projects.
- 1.27 Municipal governments need to strengthen their economic and management capacity considerably to spur decentralization. The government's strategy acknowledges the role of local governments as autonomous authorities, engaged mainly in the delivery of local public services and promoting local development. This presents a major challenge for several reasons, including the lack of basic mechanisms for the coordination and monitoring of activities, and the limitations of local stakeholders, especially in the poorest parts of the country targeted by the PRS.
- 1.28 For the decentralization process to be viable and sustainable, the municipios need strengthening, significantly more local resources must be harnessed, and more efficient structures need to be set up for basic service delivery, such as partnerships or leagues of municipios. The municipal sector in Honduras is highly fragmented with the municipios possessing scant economic, financial, or management capacity. The country's 298 municipios fall into four categories: A, B, C, and D, category A being the most developed, and category D, the poorest. Table I.2 provides a breakdown of the municipal sector. Analysis in terms of planning, programming, financial sustainability, maintenance of capital investments, and whether standards, procedures, and internal and social control mechanisms are in place indicates that category A municipios and roughly half of category B municipios are in a position to take over the FHIS project cycle. The capacity of C and D category municipios is limited with central government transfers representing up to 85% of their revenues.

Table I.2
Breakdown of Municipios by Category

Category	Municipios		Population		Population Range	
	Number	%	Number	%	Min.	Max.
A	24	8.0	3,070,327	47.0	10,538	906,129
B	62	21.0	1,205,477	18.4	1,408	67,834
C	123	41.0	1,653,920	25.3	1,962	64,704
D	89	30.0	605,620	9.3	1,078	24,157
Total	298	100.0	6,535,344	100.0	1,078	906,129

2. Phase II reforms of the FHIS

- 1.29 The phase I evaluation shows that the FHIS has met most of the indicator targets, emerging as one of the government's most important tools in the fight against poverty. Phase II will realign it as a strategic player in the decentralization process in partnership with other key stakeholders. The budding process of project cycle delegation shows promise and will be phased in, starting with the strongest municipios and fine-tuning the approach as necessary to streamline the process. Project cycle delegation should be broadened gradually, as municipal and FHIS capacity to support the process allow.
- 1.30 Efforts to work more closely with communities and municipios to better meet their needs will be stepped up in phase II based on lessons learned. The recommendations that came out of the participatory planning pilot project will be implemented and broadened to the national level. The works maintenance pilot will be rolled out to all the poorest municipios. The project cycle will be simplified, and the manuals revised to make them easier for the municipios to understand. The FHIS will make the necessary internal adjustments to its structure and systems to enhance its long-term impact. Investment will continue to focus on social infrastructure projects targeting the poorest of the poor.
- 1.31 Local development is a complex issue involving many stakeholders; the FHIS is a key stakeholder, but not the only one. Phase II will establish clear policies, procedures, rules, and regulations that promote coordinated local development activities. The role and responsibilities of local stakeholders and the government will be clearly defined, a task that will demand the SGJ's active participation.

3. The SGJ's role in decentralization

- 1.32 The Government of Honduras views decentralization as a tool of state reform that can make public service delivery more efficient, effective, and transparent. Currently at the consultation and consensus-building stage, the decentralization and local development program (PRODEL) sets a series of local development goals including strengthening participatory democracy and picking up the pace of local economic development. It also asks municipal governments to help ease the country's fiscal constraints by harnessing more local tax revenues. However,

significant challenges remain in the municipal sector and in the area of decentralization: mending gaps in the municipal legal framework; nurturing constructive public dialogue on modernization and/or decentralization strategies for each of the different sectors based on technical analysis of existing conditions; strengthening interagency coordination; and designing and implementing nuanced development policies for two distinct groups of municipios, the 58 where 50% of the population live and most of the country's economic activity is concentrated, and the remaining 240, which represent 80% of all municipios.

- 1.33 By law, the SGJ is the agency with authority to establish the framework of policies, tools, rules, and regulations to promote decentralization and local development. Yet prior to the present administration its activities were limited by scant fiscal and human resources and an inability to establish its authority in these areas. Progress has been made in the past year on the objectives for a national decentralization policy, but no final policy or strategy has been mapped out in conjunction with other stakeholders, whose involvement is critical, nor has the municipal fiscal structure been strengthened or the legal framework recast. The SGJ is seeking to again play a key role by creating the institutional conditions and policy framework for decentralization to contribute to more efficient and equitable allocation of public assets.
- 1.34 With its keen understanding of local conditions and commitment to closer coordination with the SGJ and transferring the project cycle to more municipios, the FHIS is now positioned as the principal tool for channeling resources into social investment and a strong partner with a key role to play in the decentralization process.

4. Conclusion

- 1.35 The current economic climate presents a unique opportunity for the Bank to support the government in identifying how and where a decentralized approach might help the PRS succeed and foster development in Honduras. It also gives the FHIS an entrée into a broader state reform process through partnership with the SGJ and local governments.
- 1.36 The FHIS is a key player in the fight against poverty. The phase I evaluation showed that its social infrastructure investments are of high quality and benefit the poorest of the poor. Delegation of the project cycle must be a gradual process involving only those municipios with the demonstrated capacity to take it on. Municipal governments need strengthened economic and management capacity, if they are to support decentralization. Lastly, the evaluation revealed the need for SGJ involvement in phase II, to establish the policies, tools, rules, and regulations that will underpin the decentralization and local development process. Coordination between the FHIS and SGJ on a single program is expected to create synergies that will empower and raise the living standards of ordinary Hondurans, and contribute

to effective implementation of the PRS. In conclusion, the project team recommends that the Board of Executive Directors approve phase II of the Poverty Reduction and Local Development Program for up to US\$35 million.

II. PHASE II

A. Objectives and principles

- 2.1 The purpose and goal of the program will be the same in phase II as originally approved by the Board with the addition of the notion of sustainability of services. The general objective is to help improve the living conditions of the poor by providing greater access to sustainable basic social services with community participation. Phase II will support PRS implementation and the local development process in Honduras by emphasizing: (i) strengthened local capacity; (ii) citizen participation; (iii) sharing responsibility with local stakeholders; (iv) incentives to promote local development and innovative management; (v) scientific natural resource management at the local level; (vi) transparency and accountability; and (vii) setting up monitoring and periodic evaluation mechanisms.

B. The program

- 2.2 Phase II of the poverty reduction and local development program builds on lessons learned from phase I, taking a more comprehensive approach to poverty and local development. It also draws on the new government policy, adding the SGJ as co-executing agency with the task of coordinating, monitoring, and establishing a regulatory framework for the decentralization and local development process. The FHIS will continue targeting social investment to the neediest segments of the population and gradually delegating project cycle responsibilities to the local level.
- 2.3 The program supports four prongs of the PRS through policies and social investment: (i) priority ranking of activities in the least developed sectors and parts of the country; (ii) strengthening of governance and participatory democracy; (iii) an enhanced role for municipios and communities; and (iv) environmental protection. Social infrastructure investments in the education, health, water, and sanitation sectors will be instrumental in meeting the milestone indicators and overall goals of the PRS. The program also employs transparent targeting mechanisms, to ensure higher per capita investment in the poorest municipios.
- 2.4 Phase II will extend the key phase I components in support of a medium-range outlook reflecting FHIS/SGJ synergies in the area of local development. Activities in the same areas as phase I will support investment in basic social infrastructure and enable Honduras to extend its decentralization efforts and strengthen interagency coordination. Municipios and communities will also play a more active role in all aspects of the program in the interest of more sustainable investments. The program components will be: (i) investment in basic social infrastructure; (ii) municipal and local management; and (iii) strengthening the institutional framework.

- 2.5 Table II.1 summarizes the principal activities under each component and expected outcomes at the end of the program. Annex II presents the full logical framework developed in conjunction with local counterparts and others involved in the preparation of phase II.

Table II.1
Phase II Activities and Key Indicators

Components and activities	Expected outcomes
1. Investment in social infrastructure <ul style="list-style-type: none"> • Execution of basic social infrastructure projects. • Active community participation in the planning, supervision, and maintenance of social infrastructure projects. • The FHIS gradually broadens operational delegation of the project cycle to the strongest municipios 	<ul style="list-style-type: none"> • US\$22 million in projects executed in the education, health care, water, and sewerage sectors. • Service coverage expanded in basic education, primary and preventive health care, water, and basic sanitation. • The percentage of households with unmet basic needs declines. • 80% of beneficiary households consider satisfactory the facilities or the quality of the works that deliver basic social services to them. • 40 municipios take over social infrastructure project development, contracting, execution, and supervision. • 90% of projects executed under centralized and decentralized models receive a satisfactory quality rating.
2. Municipal and local management <ul style="list-style-type: none"> • Municipal strengthening in the areas of: (a) finance and administration; (b) municipal planning; (c) environmental management; (d) cadastres; and (e) modernization of municipal services. • Encourage innovation at the local level. 	<ul style="list-style-type: none"> • A minimum of 20 municipios have completed a comprehensive technical assistance and training program. • A minimum of 60 proposals received from municipios and/or communities for the use of funds awarded by competition • Good practices disseminated twice a year through the media and publications.
3. Strengthening the institutional framework <ul style="list-style-type: none"> • Establishment of mechanisms for interagency coordination • Development of instruments. • Design of policies and standards. 	<ul style="list-style-type: none"> • Agreement reached on decentralization and local development strategy, and work plan of the Executive Commission for Decentralization of the State executed. • Municipal information system developed and accessible online. • FHIS restructuring plans executed.

1. Component 1. Investment in social infrastructure (US\$25.9 million)

- 2.6 The objective of component 1 is to help meet the basic needs of the poor by providing greater access to basic social services. Social projects identified and assigned high priority through local participatory planning processes will be funded, and responsibilities transferred to communities and municipios with the

interest and capacity. Basic social infrastructure projects targeting the most vulnerable groups will include the construction, repair, expansion, and replacement of works, and the purchase of equipment, and materials for the basic education, health, water, and sanitation systems. Financing will be provided for preinvestment, investment, supervision, and training costs associated with works maintenance and social audits of projects. Training will also encourage women to become more actively involved and take on a greater role in the development of their communities.

- 2.7 Ex ante appraisals by the FHIS will determine the technical, financial, economic, institutional, and environmental viability of all projects. Reviews of shared responsibility and cofinancing arrangements with local stakeholders will be incorporated into participatory planning, preinvestment, execution, maintenance, operations, and training. Projects will establish cutoffs and comply with technical standards set by the relevant ministries. Cost-efficiency or cost-benefit analyses will be employed as necessary. Analysis of the demand for services, project sustainability, and environmental impact studies will dictate the size of works. A mechanism will be set up to validate unit price master agreements based on annual market studies of materials and services conducted by private firms.
- 2.8 **Allocations to municipalities.** The FHIS has used the poverty map as a basis for targeting investment in all Honduran municipios. The poverty index given for each municipio is the weighted sum of four indicators: (i) the percentage of households without running water; (ii) the percentage of households without access to basic sanitation; (iii) the undernutrition rate; and (iv) the illiteracy rate. The National Statistics Institute (INE) is coordinating an update to the poverty map, based on the 2001 census results. The formula for allocating resources at the municipal level is based on the poverty index and population density with calibration mechanisms to ensure a minimum allocation to each municipio.
- 2.9 Allocations to municipalities will be contingent upon a new cofinancing arrangement that seeks to tap more local resources for anti-poverty efforts and achieve greater equity between financially stronger municipios and those less well off. The FHIS has developed a tiered responsibility sharing mechanism, under which municipios with more wherewithal will cofinance projects at higher levels. Municipio categories and their cofinancing levels for works projects would be: (i) developed, 50%; (ii) underdeveloped, 30%; (iii) poor, 10%; and (iv) undeveloped, 5%. For “poor” and “undeveloped” municipios, cofinancing can include costs incurred and booked for project design, preventive maintenance, supervision, land/materials donated, etc.
- 2.10 **Municipal participatory planning.** All projects financed by the FHIS must be identified and priority ranked through participatory planning processes for municipal strategic planning, and must figure in a municipal investment plan. The minimum requirements for validation of participatory plans are described in

part III. Support for guidance, training, and oversight activities seeks to foster equitable involvement of men and women in municipal participatory planning.

- 2.11 **Maintenance and social audits.** Community training on works maintenance will continue to be funded for each project. The FHIS will require municipal investment plans to include a maintenance plan for program-funded works, and community-based management committees to be set up for social control of each project. The goal will be clear and effective communication between contractors and the municipios and communities, fostering a citizen culture of joint management partnerships.
- 2.12 At the same time, the FHIS will roll out the preventive maintenance mechanism being piloted in phase I for standard works to some 50% of the country's poorest municipios, targeting at least the basic education and health system infrastructure financed by the FHIS since 1999. The municipios will receive assistance in estimating the cost of necessary repairs and preparing annual maintenance plans. As part of the local contribution, the central government will furnish a portion of the funds for the maintenance plan. The municipios and communities will also contribute own resources and labor. The maintenance mechanism will provide incentives for physical and financial planning of sustainability activities.
- 2.13 **Operational delegation of the project cycle.** To further decentralization and local development efforts the FHIS will gradually broaden operational delegation of the project cycle to municipios and leagues of municipios. Municipio selection will rely on a certification mechanism that evaluates technical, administrative, and financial aspects of project management.
- 2.14 To be eligible for FHIS delegation of the project cycle, municipios must also: (i) possess a project unit with qualified technical staff or be ready to establish effective execution mechanisms; and (ii) have filed a budget outturn for the most recent fiscal year with the Tribunal Superior de Cuentas (general accounting office) and SGJ, as required by law.
- 2.15 In response to the evaluation findings, the FHIS is simplifying the project cycle, to make delegated projects easier for the municipios to execute. The DOPC methodology and operating manual are being reviewed and changed to more directly address the needs of local governments. The final outcome of the phase I DOPC pilot is still unknown; the program approach therefore will remain one of gradual expansion, first to the strongest municipios, so as to monitor progress and firm up methodology as the FHIS adjusts institutionally to the new model. Plans are to expand DOPC to some 40 municipios in phase II, but the actual number will depend on municipal and FHIS capacity.

2. Component 2. Municipal and local management (US\$6.8 million)

- 2.16 The objective of component 2 is to enhance the financial and institutional capacity of municipal governments to meet the needs articulated by the local population. This specific objective will require: (i) actions to strengthen municipal governments; and (ii) incentives for innovative municipal management. These are in line with the PRS and will complement FHIS efforts to strengthen municipal capacity in the area of project management.
- 2.17 **Subcomponent 1. Municipal strengthening and development** (US\$5 million). The program strategy for modernization of municipal governments is to strengthen all aspects of municipio management in such a way as to promote: (i) harnessing more local resources; (ii) adoption of good practices and new financial management systems; (iii) process reengineering and modernization of municipio management; (iv) modernization of municipal public utility management; (v) better environmental and risk management; (vi) local governance and transparency; and (vii) adoption of good practices in the areas of physical, strategic, and participatory planning. The program will build on the institutional strengthening activities of other donors and institutions in some municipios, placing greater emphasis on the sustainability of participatory planning processes and capital investment management.
- 2.18 Specifically, the program will fund the design and execution of municipal technical assistance plans (PATMUNIs) for at least 20 municipal governments or leagues of municipios. The 21 municipal governments that participated in the DOPC process will be eligible, along with a new group of municipal governments or leagues of municipios that meet the DOPC minimum capacity criteria established jointly by the FHIS and SGJ, as set out in the Operating Regulations.³ Eligible activities will include the financing of technical assistance, consulting services, and equipment purchases in support of the objectives described in the preceding paragraph. Priority management areas will be identified for each municipio, and actions added to its PATMUNI to address those areas.
- 2.19 **Subcomponent 2. Incentives to promote innovative municipal management** (US\$1.8 million). Subcomponent 2 will finance institutional strengthening projects that put into practice innovations in any area of municipal management, such as: (i) municipal finance; (ii) decentralization and modernization of local public utilities; (iii) local governance and transparency; and (iv) land-use planning.
- 2.20 Incentive resources to promote innovative municipal management—the “Innovation Program” (“Programa Innovar”)—will fund projects selected through a

³ These criteria have been validated by field studies and address six areas: (i) financial strength; (ii) management capabilities; (iii) technical capabilities; (iv) administrative capabilities; (v) interagency coordination; and (vi) services to the poorest of the poor.

competitive process open to all Honduran municipios. The National Committee on Municipal Training and Technical Assistance (CONCAM) will choose the winning projects. The program Operating Regulations contain per-project financing levels, a list of eligible areas, a description of the competitive processes, the selection criteria, and project execution and monitoring mechanisms. Special effort will be made to promote the Innovation Program to Afro-descended and other ethnic groups.

3. Component 3. Strengthening the institutional framework (US\$3.6 million)

- 2.21 Component 3 will support institutional reforms to ensure that the FHIS and SGJ can perform their function within the PRS and PRODEL framework.

a. Subcomponent 1: Modernization of the FHIS (US\$0.8 million)

- 2.22 This subcomponent will support strengthening of the FHIS and restructuring of its operations around two existing management models: a *centralized* model for near-nationwide service coverage, and a *decentralized* model recently piloted in a small number of municipios. The objective is to further develop and improve these two management models, financing technical assistance, training, equipment purchases, and better information systems in three main areas (see below). The terms of reference, which are available for consultation in the program technical files, call for: (i) review of the FHIS operations handbook; (ii) review of technical standards for prototype projects; (iii) training on how to use the information system; (iv) development of a municipal operations manual written specifically for DOPC; (v) training on the project cycle; (vi) a technology development plan; (vii) a chief technical advisor to coordinate institutional strengthening of the FHIS; and (viii) a midterm review of the FHIS.
- 2.23 **Restructuring FHIS operations.** The short- and medium-term objectives in this area are: (i) a more efficient organizational structure, better attuned to the FHIS's strategic mission; and (ii) considerably less duplication of functions, redundant staffing, and administrative overhead. Technical assistance will support implementation of a plan to redeploy FHIS staff more effectively; review of the functions and size of each department within the FHIS; enhancements to the preinvestment, contracting/award, control, and monitoring processes; instituting more efficient project cycle management procedures; and new human resource management systems. To make the FHIS more effective in its work, staff also will receive sensitivity training to raise awareness of Afro-descended and other ethnic groups.
- 2.24 **Institutional development in support of the decentralized model.** Efforts in this area will include technical assistance to consolidate and build consensus around the decentralized model of municipal involvement and project management in

preparation for its implementation in phase II; and to develop a municipal operations manual written specifically for DOPC. FHIS staff will also receive training on project design, evaluation, contracting, control, and monitoring under the decentralized model. Technical assistance will support the development of efficient costing, hiring, management, and public relations systems relevant to the decentralized cycle. Training will be based on case studies and lessons learned from phase I.

- 2.25 **Technology development plan.** The objective in this area is implementation of an institutional technology development plan for the FHIS. Technical assistance will support the overhaul and upgrading of information system and networks; redesign of existing applications databases; new applications for monitoring performance indicators; management reports on centralized and decentralized models; documentation of processes and applications; design, configuration, and documentation of servers and network infrastructure; manuals and user's guides; and the development of more efficient accounting and financial control systems, to facilitate monitoring of budget execution by cost center.

b. Subcomponent 2: Strengthening the SGJ and policy framework (US\$2.8 million)

- 2.26 Subcomponent 2 seeks to establish an institutional and policy framework as a firm foundation for more effective decentralization and local development in Honduras, financing activities in three main areas: (i) support for interagency coordination; (ii) support for policy design and implementation; and (iii) development of standards, instruments, and systems. The terms of reference for major consulting assignments are available for consultation in the program technical files.
- 2.27 **Support for interagency coordination and institutional strengthening (US\$1 million).** As a cross-cutting process, decentralization carries implications for interagency relationships and reforms. It therefore demands institutions with the technical capacity and influence to support strategy/policy design and push through the necessary reforms. The program will strengthen intergovernmental coordination mechanisms, supporting institutional reform activities in four areas: (i) resurrecting the Executive Commission for Decentralization of the State (CEDE), to serve as the executive branch's apex body for the decentralization process; (ii) strengthening the SGJ, including its Technical Unit for Decentralization (UTD); (iii) development of a public relations and social marketing plan to promote decentralization, targeting the legislative branch, the public and private sectors, unions, and civil society; and (iv) strengthening mechanisms for consensus-building, consultation, and interagency dialogue with government institutions, municipios, and the network of organizations participating in decentralization and local development activities. Areas (iii) and (iv) will seek to raise awareness among SGJ staff of the ethnic dimension of poverty.

- 2.28 **Support for policy design and implementation** (US\$0.8 million). The program will fund technical assistance in policy design, mainstreaming, and implementation, covering four priority areas: (i) fiscal and financial decentralization; (ii) decentralization of public utilities; (iii) municipal taxation; and (iv) strengthening municipal human resources.
- 2.29 Fiscally responsible decentralization means striking a balance between decentralized spending, on the one hand, and local taxpaying capacity and intergovernmental transfers on the other, to arrive at a fiscally neutral outcome for the country. The program will support fiscal and financial decentralization to: (i) better coordinate funding for public investment at the local level; (ii) set up a system of intergovernmental transfers that promotes more efficient local management and more equitable distribution; (iii) develop, in conjunction with the finance ministry (SEFIN), municipios, and banking system, standards and operating guidelines to tighten rules on municipal borrowing; and (iv) work closely with SEFIN and line ministries to develop sector-by-sector roadmaps for decentralization with guidelines for regional, program-based budgeting and budgetary regulations for decentralizing sectors. The program also will support a number of discrete sector initiatives, especially for public utilities.
- 2.30 Honduras has a very weak tax system in terms of both revenues and the administrative ability of the vast majority of municipios. In an effort to generate higher tax revenues for municipios, consultants will: (i) propose a simpler, clearer framework for municipal taxation; (ii) devise special arrangements for small municipios, to promote joint management as a way of collecting more revenue and heightening financial efficiency; and (iii) develop legal instruments to codify such reforms.
- 2.31 In conjunction with the government, a strategy will be mapped out for strengthening municipal technical capacity and promoting municipal government service as a career. The program will fund feasibility studies on setting up a municipal civil service, establishing professional standards by consensus, and advancing a system of certification for municipal government workers and others. Professional development activities also will be funded.
- 2.32 **Development of standards, instruments, and systems** (US\$1 million). The program will fund development of basic technical instruments for better management of local development and decentralization processes, including: (i) upgrades to the municipal information system (SINIMUN), to track fiscal decentralization, municipal finances, and municipal performance indicators, standardizing national reporting on municipios and setting up a permanent operational unit to coordinate with other systems under the INE agreement to produce higher-quality municipal statistics; (ii) establishment of a policy framework to govern municipal financial management systems consistent with national regulations, as well as the design and activities to promote prototypes of

such systems; (iii) standards and instruments for municipal strategic planning, transparency, and social audits; and (iv) development of standards and models for various kinds of municipal cadastres for municipalities and service providers to use.

C. Cost and financing

- 2.33 The estimated total cost of program phase II is US\$38.9 million, broken down as follows: (i) US\$35.0 million in a Bank loan from the Fund for Special Operations (FSO); and (ii) US\$3.9 million in local counterpart funding from the Government of Honduras. Table II.2 itemizes program costs and financing by expenditure item and source.

Table II.2
Cost and Financing

	Cost (US\$000)		Total	
	IDB	GoH	Amount	%
Component 1: Social investment	23,741	2,245	25,986	66.8%
Allocations to municipalities	21,957	220	22,177	57.0%
Training	1,559	-	1,559	4.0%
Preventive maintenance	225	2,025	2,250	5.8%
Component 2: Municipal and local management	6,275	475	6,750	17.4%
Municipal strengthening	4,700	300	5,000	12.9%
Innovation Program	1,575	175	1,750	4.5%
Component 3: Institutional framework	3,310	322	3,632	9.3%
Modernization of the FHIS	785	41	826	2.1%
Strengthening the SGJ and policy framework	2,525	281	2,806	7.2%
Management (SGJ)	689	77	766	2.0%
Evaluation and audits	635	-	635	1.6%
FHIS	405	-	405	1.0%
SGJ	230	-	230	0.6%
Subtotal	34,650	3,119	37,769	97.1%
Financial charges	350	781	1,131	2.9%
Interest	-	544	544	1.4%
Inspection and supervision	350	-	350	0.9%
Credit fee	-	237	237	0.6%
Total	35,000	3,900	38,900	100.0%
	90%	10%	100%	

2.34 The terms of the loan are as follows:

Source of financing:	Fund for Special Operations (FSO)
Currency:	U.S. dollars
Grace period:	10 years
Amortization period:	40 years
Commitment period:	3.5 years
Disbursement period:	Minimum: 3 years; maximum: 4 years
Interest rate:	1% per annum during the grace period, and 2% thereafter
Inspection and supervision:	1% of the total loan
Credit fee:	0.50% per annum on the undisbursed balance from the date of Board approval of the loan

III. PHASE II IMPLEMENTATION

A. Borrower and executing agency

- 3.1 The borrower and guarantor is the Republic of Honduras. The executing agencies are the Honduran Social Investment Fund (FHIS) and Ministry of the Interior and Justice (SGJ).

B. Implementation mechanism

- 3.2 The program structure and implementation arrangement take the activities to be financed and the two executing agencies' capabilities into account. The FHIS will execute component 1 and strengthening subcomponent 3(1). The SGJ will execute component 2 and subcomponent 3(2).
- 3.3 FHIS and SGJ involvement in a local development program will create synergies, especially in the area of training and assistance to municipios. The FHIS will support municipios and communities on matters relating to project cycle management, while the SGJ will work to improve management and spur innovation at the municipios, offering them a complete package of assistance and access to funds awarded by competition. The FHIS and SGJ are also involved with NGOs and bilateral institutions on a working group to coordinate training and technical assistance to municipios.
- 3.4 Municipios and communities will take on a greater role in the identification, priority ranking, and execution of projects. The program will finance gradual broadening of DOPC to municipios and leagues of municipios based on transparent, established criteria such as capacity and interest level. More local stakeholder involvement in all aspects of the project cycle will pave the way for social audits, create a greater sense of community ownership of works, and make them more sustainable.

C. Operational personnel

- 3.5 The **FHIS** will employ a chief technical advisor to support coordination of institutional strengthening activities and program evaluation and monitoring activities. The chief technical advisor's main duties will be to support hiring of consultants, review consultant reports, and oversee implementation of recommendations. He or she will also support preparation of semiannual progress reports on institutional performance, technology development, and project quality under the centralized and decentralized models.
- 3.6 The **SGJ** has done a great deal to advance the government's decentralization agenda, but needs specialized technical support for project management. Thus, a

project management firm selected by international competitive bidding will provide administrative and technical support for SGJ activities under this loan. In terms of administrative support, the project management firm will be responsible for all administrative/financial duties and activities necessary for effective, efficient, and transparent execution of the program. This will include the preparation of bidding documents, publishing notices, evaluating proposals, and selecting and hiring consultants and consulting firms. The project management firm will provide technical support for execution of components involving training and technical assistance to municipios; design of policies, reforms, and instruments for decentralization and local development; and overall tracking of program activities and objectives.

- 3.7 Three consultants will provide additional support to the SGJ: (i) a program coordinator, who will act as liaison between the project management firm and the SGJ; (ii) a municipal technical assistance specialist, who will track activities to strengthen and foster innovation in municipal management; and (iii) an administrative technical assistant. These three consultants will work under the supervision of the director of the SGJ's Technical Unit for Decentralization (UTD).
- 3.8 A UTD advisory committee of local experts and up to three international experts in decentralization and municipal development will guide the SGJ in assessing and targeting program activities and impacts. Specifically, the advisory committee will support oversight of the midterm review and final evaluation. Detailed terms of reference for the advisory committee are available for consultation in the program technical files.
- 3.9 CONCAM will support the UTD as well, through technical consultation on program activities to strengthen municipios. Members of these groups include government and educational institutions, municipal development organizations, and international cooperation agencies.

1. Component 1. Investment in social infrastructure

- 3.10 For the basic social infrastructure component, the **FHIS** will: (i) allocate resources and regulate their availability to municipios based on the poverty map; (ii) establish and regulate shared responsibility arrangements based on specified criteria; (iii) conduct an ex ante evaluation of projects from the technical, economic, financial, institutional, and environmental standpoints; (iv) store original documents from the file on the evaluated project and maintain an automated summary report on the ex ante evaluation for each project, in accordance with procedures set out in the FHIS operating manual; (v) help train local governments and communities in aspects of the project cycle, as necessary; (vi) delegate project design, tendering, contracting, and supervision to certified municipios; (vii) transfer resources into special accounts; (viii) contract for concurrent audits; and (ix) administer, monitor,

and evaluate project impacts and the program as a whole (centralized and decentralized project management).

- 3.11 For a project to qualify for acceptance and registration by the FHIS: (i) it must satisfy the FHIS project eligibility requirements; (ii) resources must be available for the municipio based on the poverty map; (iii) the project must be part of an FHIS-approved municipal investment plan, and the municipio must enter into a shared responsibility arrangement; (iv) the project profile must be complete and satisfy the technical requirements.
- 3.12 For validation, a planning process or, especially, the roster of projects to be funded by the FHIS must satisfy at least these minimum requirements: (i) the project identification process must have been demonstrably participatory, involving communities, women, and vulnerable groups; (ii) the municipio and communities must have committed to share responsibility for project execution; (iii) the community must have a management committee to exercise social control over each project; and (iv) the plan must include a works maintenance program that calls for training to communities. Official municipal council and municipal development council approvals of the municipal investment plan must also be submitted.
- 3.13 The **local government** will: (i) coordinate, build and reach consensus with local stakeholders on municipal social investment plans (PISMs) or strategic development plans based on municipio capacity; (ii) contribute local resources in accordance with shared responsibility arrangements set out in the Operating Regulations and other requirements of the PISMs; and (iii) ensure community participation in project execution. For municipios participating in project cycle delegation, the local government also will: (i) design, execute and supervise projects, conduct tenders and award contracts for such activities, and issue calls for bids and award contracts for supplies and services in eligible categories; (ii) maintain separate bank accounts specifically for program resources; (iii) employ an accounting and financial control system for each program that can be used to audit uses of funds in relation to categories of eligible expenditures under the program; (iv) store in an orderly manner all such project documentation and original contractual documents as may be needed for project closure; (v) submit audited financial statements to the FHIS; (vi) assume accountability to local stakeholders and the FHIS for project management and execution; and (vii) participate in all training and evaluation activities.
- 3.14 The **SGJ** will: (i) set policy on decentralization of social and economic investment; (ii) provide planners in municipios with information on central government resources available for investment; (iii) approve a project profile guide for projects under municipal investment plans; and (iv) approve the mechanism for gauging the ability of municipios and leagues of municipios to take over the project cycle from the FHIS.

2. Component 2. Municipal and local management

- 3.15 **Eligibility and selection of municipios.** To be eligible for this component, municipal governments must have participated in the DOPC process; new municipios must meet the DOPC minimum capacity requirements described in paragraphs 2.13 and 2.14. All eligible municipios will be invited to take part in the program, so that at least 20 local governments will benefit. Applications for the program must include: (i) a statement of interest in participating in the program, signed by the mayor on behalf of the municipal corporation; (ii) certification that a budget outturn was filed for the most recent fiscal year with the SGJ and Tribunal Superior de Cuentas (general accounting office); (iii) a self-evaluation of institutional performance that measures a set of key indicators for municipal planning, service delivery, and environmental and financial management, based on a self-evaluation manual provided by the SGJ; and (iv) proposed targets for raising these indicators over the next two years. The SGJ will rate applications on the basis of the self-evaluation manual described above.
- 3.16 **Implementation of municipal technical assistance plans (PATMUNIs).** The cycle for design, approval, and implementation of the PATMUNIs described in paragraphs 2.17 and 2.18 will be as follows: (i) the SGJ, through the project management firm, will invite eligible municipal governments to join the program; (ii) interested municipios that meet the requirements of paragraph 3.15 will attend a startup workshop covering program objectives and methods, resources available to each municipio, rules governing the activities to be funded, and how to formally join the program; (iii) the SGJ and beneficiary municipio will sign a framework agreement; (iv) the PATMUNIs will be prepared and executed with support from consultants hired with program funds; and (v) the PATMUNIs will be monitored and supervised. Approval of the model agreement between the SGJ and municipio will be a condition precedent to the first disbursement under this component.
- 3.17 Once approved by the municipal council under the framework agreement, PATMUNIs are expected to be implemented with support from a single consulting firm for each municipio or, where possible, grouping together nearby municipios. This approach encourages more unified and organized activities, technology transfer, lower transaction costs, and shorter turnaround times, due to the smaller number of contracts. The municipal strengthening advisor will oversee technical assistance activities.
- 3.18 **Innovation Program.** All municipios are eligible to propose municipal innovation projects for funding under the program. Projects may be proposed in any area relevant to good municipal management, such as: (i) municipal finance; (ii) decentralization and modernization of local public utilities; (iii) local governance and transparency; and (iv) promoting local economic development. Projects will be selected for funding through two competitions held over the course of the program. Announcements will be sent to all mayors and placed in the mass

media. The competitions will award US\$875,000 for at least 17 innovation projects of US\$50,000 to US\$100,000 each. The funds are to be used for technical assistance, training, and equipment purchases. For a level playing field, each competition will split the municipios into two separate categories or groups: one for municipios with a population over 30,000, and another for municipios with a population of 30,000 or more, alone or in partnership with others.

- 3.19 CONCAM will select the winning projects with support from the project management firm. CONAM will base its evaluation of proposals on the following factors: (i) sustainability of project outcomes; (ii) partnerships and private and/or community involvement in project execution; (iii) contribution to democratic institutional reform and governance; (iv) impact on improving municipal performance indicators; (v) use of economies of scale; and (vi) counterparty commitment. Winning innovation projects will be executed with support from the project management firm under the terms of an agreement entered into between the beneficiary municipal government and the SGJ. Approval of the model agreement between the SGJ and municipio will be a condition precedent to the first disbursement under this component.

3. Component 3. Strengthening the institutional framework

- 3.20 **Subcomponent 1. Modernization of the FHIS.** The FHIS will contract for consulting services necessary to: (i) support restructuring of its operations and help implement the technology development plan; (ii) provide technical assistance to manage the centralized project cycle more efficiently and solidify the model for decentralized municipal action and project management for implementation during phase II; (iii) train FHIS personnel; and (iv) revise its operating manuals. The FHIS has already begun execution of this subcomponent, so that many of the phase II investments can be made under the new policies and procedures.
- 3.21 **Subcomponent 2. Strengthening the SGJ and policy framework.** The project management firm will contract for and manage consulting services necessary to: (i) strengthen the SGJ in key areas; (ii) design the policy framework for decentralization; and (iii) develop guidelines and support systems for the decentralization and local development processes. The SGJ technical advisor for this subcomponent will provide technical oversight of consulting assignments and quality control, and support awareness and consensus-building activities, under an annual work plan agreed upon with the SGJ. The Operating Regulations contain guidelines for first-year work plans.

D. Evaluation

- 3.22 **Midterm review.** Once 50% of program resources have been committed and/or 35% disbursed, an outside firm will be hired to conduct a midterm review under terms of reference to be agreed upon with the executing agencies. The midterm

review will evaluate program progress, providing FHIS and SGJ management with immediate feedback on what has been achieved, and where room remains for improvement as a basis for recommending changes.

- 3.23 For the FHIS, the midterm review will evaluate primarily: (i) how funds are targeted, so that more resources go to poorer municipios; (ii) how the poor's access to basic social services has changed; (iii) the quality and impact of funded subprojects; (iv) the extent to which recommendations of institutional development studies have been implemented; (v) the extent to which decentralization experiments have strengthened municipios and improved their operations; (vi) the level of women's involvement in participatory planning, execution, and maintenance; (vii) how local stakeholders cofinance and share responsibility for participatory planning, preinvestment, execution, maintenance, and operation; (viii) the extent of interagency coordination and the FHIS's relationship with line ministries and others; and (ix) whether procurement procedures are flexible, efficient, and effective.
- 3.24 For the SGJ, the midterm review will evaluate: (i) progress on institutional reforms and their sustainability; (ii) progress on designing the decentralization strategy, and its implementation in key sectors and elsewhere; (iii) the effectiveness of the public relations campaign on various target groups; (iv) the extent to which municipal indicators, financial management systems, and models for municipal property records are being accepted and used; (v) improvement in municipal performance indicators at municipios participating in the technical assistance program, relative to a control group; (vi) quality and effectiveness of municipal technical assistance, according to the municipios and outside experts; (vii) levels of municipio participation in the Innovation Program, and project quality; (viii) level of cofinancing of winning projects by other nongovernmental organizations; and (ix) use of the municipal information system (SINIMUN) by government agencies and nongovernmental organizations.
- 3.25 **Final evaluation.** Once 90% of program resources have been disbursed, an outside firm will be hired using program funds to evaluate performance, outcomes, and lessons learned from all three components. The evaluation findings will serve as inputs for the design of future Bank operations in the sector.
- 3.26 The IDB is working in conjunction with the World Bank to evaluate the impact of FHIS projects from 1998 to 2002. The final results of this evaluation, now under way, are expected in December 2003. The methodological framework seeks to confirm that these investments: (i) reflect the priorities of communities and beneficiaries; (ii) target the poorest of the poor; (iii) are of high quality; (iv) give the target population greater access to basic social services; and (v) foster a sense of community ownership. The study will lay the foundations for a system to evaluate the FHIS's impact and regularly gauge the long-term effects of investments at the household level.

- 3.27 **Baseline data.** The FHIS and SGJ will provide the Bank with baseline data and the procedure for compiling and processing annual data within 12 months after the contract enters into effect. FHIS baseline data are being gathered and will be ready by program start. Baseline data for the SGJ components will be gathered during the first year of program execution. Indicators will cover the areas described in paragraphs 3.23 and 3.24, and will be used for the midterm review and final evaluation.

E. Procurement of works, goods, and services

- 3.28 Procurement of works, goods, and consulting and other related services will conform to Bank policies and procedures. International competitive bidding will be required for construction contracts with an estimated cost of US\$1.5 million equivalent or more, US\$250,000 equivalent or more for goods, and over US\$200,000 equivalent for consulting services. Procurement of works, goods, and services which fall below such thresholds will be governed by Honduran legislation. The FHIS is one of five ministries receiving training and technical assistance under the program for efficiency and transparency in government procurement and contracting (loan 1059/SF-HO).

F. Disbursements

- 3.29 The commitment period for program resources will be 42 months. The minimum disbursement period will be 36 months, and the maximum 48 months, both running from the time the loan contract enters into effect. Table III.1 shows the phase II disbursement timetable by source of financing. This programming seems reasonable, given the capacity of the FHIS, which executed an average of US\$45 million in projects annually in 2000-2002.

Table III.1
Phase II Disbursement Timetable

Source	Year 1	Year 2	Year 3	Total	%
IDB/FSO	13,132	11,964	9,904	35,000	90
Local	1,459	1,329	1,112	3,900	10
Total	14,591	13,293	11,016	38,900	100
%	37.5	34.2	28.3	100.00	

- 3.30 In order to ensure implementation of FHIS strengthening activities, disbursement of more than 30% of component 1 resources (investment in social infrastructure) will be contingent upon the Bank receiving satisfactory evidence that progress is being made on the plan for modernization of the FHIS (component 3(1)).
- 3.31 **Revolving fund.** The Bank financing resources will be deposited through the Central Bank of Honduras into two separate accounts exclusively for program

execution: one for the FHIS, and the other for the SGJ. Counterpart resources also must be deposited at the same institutions in two separate accounts exclusively for program execution. It is recommended that two revolving funds be set up in line with Bank policies to facilitate program execution, not to exceed 5% of the total financing for the respective FHIS and SGJ activities.

- 3.32 **Special accounts.** For operational delegation of the project cycle, the FHIS will transfer program funds to special accounts opened by participating municipalities at commercial banks. These accounts will also be used to deposit cofinancing funds, where applicable. The FHIS will transfer 100% of the project cost to the municipality, including supervision, training, and equipment purchases, once the project has been contracted.
- 3.33 **Internal control.** The FHIS will properly document its operations by keeping on file records and supporting documentation on all transactions. All project cycle documentation must be stored in the relevant file. The FHIS's internal audit department will periodically audit the reports generated by the reporting system, to ensure accuracy and reliability.
- 3.34 The FHIS will upgrade its current accounting system to a full, multicurrency system supporting multiple charts of account. Basic monthly financials will be generated with current and cumulative information on total investment outlays, revenues, current expenditures, and cash on hand. These reports must square with the total bank account balances under the agreement with the Bank.
- 3.35 For the SGJ, the project management firm must keep on file all documentation on the running of program activities, as specified in the service delivery contract.
- 3.36 **Monitoring and inspections by the Bank.** All FHIS and project management firm procurement processes will be subject to ex ante review. The Bank's Country Office in Honduras will conduct field inspection visits at least once every six months to determine, by a sampling of projects, project quality, progress on project cycle delegation, community satisfaction, and other aspects of project execution. The visits will also gauge how strong a sense of ownership participating local governments have in the municipal management component.
- 3.37 **Partial disbursement of resources.** The project team recommends disbursing up to US\$200,000 for the SGJ to move ahead with the technical activities necessary for execution of program component 2, subject to fulfillment of the conditions precedent to the first disbursement as stated in the general conditions of the loan contract. These resources will fund: (i) the design of a goal-setting system for PATMUNIs; and (ii) finalization of a first group of PATMUNIs.

G. Reporting

- 3.38 The FHIS and SGJ will submit semiannual progress reports to the Bank within 30 days after the end of each six-month period during program execution. These reports will provide information on progress achieved and problems encountered in the reporting period. Additionally, in November of each program year the executing agencies will submit an annual work plan (AWP) in accordance with requirements previously agreed upon.

H. Audits

- 3.39 The executing agencies will prepare and keep accounts and records in accordance with accepted accounting practices. The FHIS and SGJ will submit financial statements on their program components within 120 days after the end of each fiscal year. These financials must be audited by a firm of independent auditors acceptable to the Bank. The FHIS also will submit concurrent, interim audit reports on the program components for which it is responsible.

IV. VIABILITY, BENEFITS, AND RISKS

- 4.1 The FHIS assesses all projects to ensure their viability from the financial, technical, economic, institutional, and environmental standpoints.

A. Financial viability

- 4.2 Fiscally responsible decentralization means striking a balance between decentralized spending, on the one hand, and local taxpaying capacity and municipal transfers on the other, to arrive at a fiscally neutral—if not positive—outcome for the country.

- 4.3 The line ministries absorb the bulk of the program's recurrent costs, mainly education and health care worker pay, equipment, teaching materials, and medicine. Projects to expand, repair, or replace existing establishments generally have no impact on recurrent costs. A financial feasibility appraisal will be required for new construction. For works maintenance, the FHIS will promote a shared responsibility arrangement involving the central government, municipios, and communities.

B. Technical and economic feasibility

- 4.4 Project technical designs comply with the standards and requirements of each line ministry. Prototypes originally designed with each sector are generally used. Ex ante project appraisal includes cost-efficiency or cost-benefit analysis, where applicable; the use of cutoffs; and scaling of works based on an analysis of demand for services.

C. Institutional viability

- 4.5 Phase II promotes FHIS integration into the state reform process. While maintaining its institutional autonomy, the FHIS will act within a national framework establishing the role and responsibilities of all involved. The program will ensure that the FHIS's activities dovetail with decentralization and local government strengthening initiatives.⁴
- 4.6 The FHIS has executed four Bank loans over the past 12 years, and five World Bank loans. It executed an average of US\$45 million in small-scale infrastructure projects annually in 2000-2002. The FHIS's long, solid institutional track record make it, comparatively speaking, the most efficient executing agency in Honduras.

⁴ This squares with the Bank's 2002 proposed guidelines on social investment funds, "Note on social investment funds: the IDB experience and proposed guidelines for future support."

- 4.7 The SGJ has limited experience executing programs with international organizations, but in the past two years has been working more closely with other bilateral institutions, including Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ); the Dutch, Italian, and Spanish cooperation agencies; the UK government's Department for International Development; and the European Community. For the SGJ's first experience with the Bank, a fairly straightforward component has been designed with an execution arrangement that delegates operational responsibilities to a specialized firm while strengthening the SGJ's regulatory functions.

D. Environmental and social viability

- 4.8 The FHIS project cycle requires an environmental assessment of all projects prior to approval. Standard projects (education and health) are checked to see whether the criteria included in the prototypes are provided for and/or satisfied. In all other projects, an environmental diagnostic assessment and/or environmental impact assessments are conducted, as appropriate. The municipal training to be delivered by the SGJ will include an environmental management module, to encourage sustainable natural resource management and environmental protection.
- 4.9 Consideration of gender and ethnic issues is a basic feature of the municipal participatory planning method. The activities to develop a human resources strategy under program component 2 will emphasize the role of women in municipal leadership.

E. Benefits

- 4.10 The program will contribute broadly to the poverty reduction efforts of the Government of Honduras, giving the poor greater access to social services by funding US\$22 million in small-scale social projects in the education, health, water, sanitation, and road construction sectors. Specifically, it will support expanded service coverage in early childhood and primary education, primary and preventive health care, water, and basic sanitation in rural areas.
- 4.11 Greater access to social services is expected to improve living conditions locally by raising school enrollment and attainment levels, increasing the use of primary health care services, expanding vaccination coverage, and lowering the incidence of diarrhea in the targeted areas.
- 4.12 The program employs transparent targeting mechanisms to give priority to municipios with the highest percentage of households with unmet basic needs. The poverty map and resource allocation formula ensure higher per capita investment in the poorest municipios.
- 4.13 All funded projects must be part of a municipal investment plan, arrived at through a democratic participatory process. The planning methodology fosters broad

participation of groups and communities traditionally excluded from government decision-making, such as indigenous and Afro-descended groups. It also encourages freedom of expression, to make sure that the program funds projects that have been assigned high priority at the local level. Local leadership is stimulated by training local community leaders to organize participatory planning meetings and serve as delegates to regional assemblies and community meetings.

- 4.14 Delegation of the FHIS project cycle and SGJ-sponsored ancillary activities will better position municipal governments to meet the needs articulated by the local population. The program will support municipios in project design, evaluation, contracting, execution, and supervision with the goals of building municipal technical and management capacity, making municipios more autonomous, and empowering them through technical assistance activities in municipal finance and administration, modernization of local public utilities, environmental management, local governance and transparency, and land-use planning.

F. Risks

- 4.15 The SGJ activities under the program carry risks associated with management and politics. The management risks relate to the SGJ's limited experience executing projects of this kind and the need for a stronger Technical Unit for Decentralization (UTD). This risk will be mitigated by hiring a project management firm for all SGJ activities under the loan, and setting up a management unit within the UTD, staffed with three specialist consultants.
- 4.16 The political risks relate to the decentralization process, whose continued success depends both on government leadership and on how civil society receives it. Since sustainable decentralization entails new policies and a new relationship to civil society, the program will include a public relations and social marketing plan to stimulate broad-based national dialogue.

G. Poverty-targeting and social sector classification

- 4.17 This operation qualifies as a social equity enhancing project, as described in the indicative targets for the Bank's activities set out in the Bank's Eighth General Increase in Resources (AB-1704). Furthermore, this operation qualifies as a poverty-targeted investment (PTI), supporting as it does the activities of a social investment fund. According to the PTI guidelines in force, the type of investments to be funded (education and health) qualify it "automatically" as a PTI.

POVERTY REDUCTION AND LOCAL DEVELOPMENT PROGRAM

(HO-0161)

EXECUTIVE SUMMARY

Borrower: Republic of Honduras

Guarantor: Government of Honduras

Executing agency: Honduran Social Investment Fund (FHIS)

Amount and source:	(in thousands of U.S. dollars)		
	Phase I	Phase II	Total
IDB: (FSO)	25,000	35,000	60,000
Local counterpart :	2,800	3,900	6,700
Total:	27,800	38,900	66,700

Financial terms and conditions:

Amortization period:	40 years
Grace period:	10 years
Commitment period:	2 years
Disbursement period:	2.5 years
Interest rate:	1% first 10 years and 2% thereafter
Inspection and supervision:	1% of the loan amount
Credit fee:	0.5% per annum on undisbursed balances

Objectives: This program is in line with the Poverty Reduction Strategy (PRS), its general objective being to help improve the living conditions of the poor by providing greater access to basic social services with community participation. The program's specific objectives are: **Phase I** (i) to carry out the projects selected in the 1998 municipal social investment plans (PISMs), awaiting financing due to the backlog caused by Hurricane Mitch; (ii) to support FHIS participation in the PRS as a poverty reduction instrument, increasing its effectiveness and enhancing management capacity; and **Phase II:** (iii) to implement new intervention approaches devised from lessons learned with pilot programs executed in Phase I (paragraph 2.1).

Description: In line with the Honduran poverty reduction strategy (PRS), the program will help sustain the pace of social investment by increasing access by the poor to basic social services, while fostering community empowerment and a sense of ownership of service delivery. It is conceived as a multiphase operation using the new "multiphase lending" facility that affords flexibility by virtue of its medium-range view, transcending any one government's term in office. The program supports the transformation of the FHIS as an effective instrument for the PRS. In Phase I, financing will be provided for backlogged basic infrastructure projects and pilot programs. Phase II will use designs that proved successful in the pilot programs and apply lessons learned in Phase I. It will also act as an incentive for execution and timely evaluation of pilot programs conducted in the first phase. The move to Phase II is subject to attainment of targets denoted by specific process, outcome, and impact indicators that will signal whether the progress made is in line with the PRS's medium-term objectives. Phase I is scheduled to take 24 months and Phase II, 36 months.

With respect to allocation of program funds, the 1998 poverty map will be used for Phase I of the operation. In order to target it even more closely and give priority to municipalities with the largest numbers of poor people, the allocation formula has been improved to give greater weight to poverty and less to size of population.

Phase I of the program (US\$25.8 million) will finance:

1. **Social infrastructure investment commitments** (US\$24.2 million): comprises backlogged infrastructure projects with organization and financial specifications regarding maintenance of the works (paragraph 2.8).
2. **Pilot programs to strengthen local communities** (US\$900,000): experiment in participatory planning, operational delegation of the project cycle, and maintenance (paragraph 2.13).
3. **Institutional strengthening of the FHIS** (US\$400,000): financing of a Technical Support Unit and technical-administrative strengthening activities (paragraph 2.34).
4. **Evaluation of Phase I** (US\$300,000): consists of an evaluation by an independent firm acceptable to the Bank, as a requirement for qualifying for Phase II financing (paragraph 2.38).

Phase II (US\$35.9 million) will finance extension of the practices shown to be successful in the evaluation of the pilot programs in the previous phase, incorporating them into the priority projects in the new Municipal Social Investment Plans (PISMs). Phase II will be compatible with the PRS design and implementing arrangement (paragraph 2.39).

This document requests the Board of Executive Directors' approval of the program concept, the proposed multiphase mechanism, and a loan for Phase I. Management would recommend approval of Phase II of the program to the Board in a memorandum containing an evaluation of qualitative and quantitative aspects of what is accomplished vis-à-vis the project backlog and the pilot program outcomes. It will also include a revised cost table and procurement plan.

The Bank's country and sector strategy:

In line with the PRS, the Bank's strategy for Honduras is geared to poverty reduction. To that end, the Bank will support initiatives aimed at enhancing the equity, efficiency, and reach of public programs. The objectives and activities proposed in this operation, as well as those of other programs being prepared and executed, are also concordant with the PRS. They include: (i) the sector program (HO-0185), dealing with compliance with policy and expenditure measures; (ii) the rural economy reactivation program (HO-0144); (iii) the urban poverty program now in preparation (HO-0184); (iv) the family allowance program (PRAF) (1026/SF-HO); and (v) the Honduran Social Investment Fund (FHIS 3) program (1028/SF-HO). These programs constitute an integrated package of measures to reduce and alleviate poverty. The operation described here is supported by the program for efficiency and transparency in government procurement (1059/SF-HO), which will supervise and strengthen the FHIS procurement system (paragraph 1.21).

Environmental and social review:

The FHIS project cycle requires an environmental assessment of projects. Standard projects (education and health) are audited to ensure that the criteria specified in the prototypes are built in and/or satisfied. In all other projects, an environmental diagnostic assessment and/or environmental impact assessments are carried out, depending on the case. The project also provides for systematic incorporation of FHIS requirements with regard to gender equity and respect for the particular needs of ethnic minorities (paragraph 2.15). Also planned are training and initiatives to heighten awareness of these issues among the personnel of the FHIS, municipalities and beneficiary communities (paragraph 4.8).

Benefits:

This program is expected to lower costs by increasing the efficiency, effectiveness and useful life of works. In the specific case of

investment in human capital, there are expected to be improvements in productivity and direct positive impacts on income, as well as indirect effects on the generation of national wealth. In addition, the adjustment to the resource allocation formula, favoring poorer municipalities, will help raise the return on social investment. It is also hoped that operational delegation of the project cycle (DOPC) will help strengthen municipal capabilities (paragraph 4.14).

Risks:

The FHIS menu may be restrictive for some communities, with certain basic social needs considered priorities for them being left unmet. To allay this risk, a negative menu will be tried out during Phase I. In Phase II, which will draw on experience acquired in Phase I, the menu will be adjusted accordingly. There is also a risk that the DOPC process might not progress at the desired pace because of the need to develop new procedures and fine-tune working methods. To minimize this risk the program will introduce DOPC gradually, starting with a pilot scheme of manageable proportions (paragraph 4.19).

Special contractual conditions:

The first disbursement will be subject to the following being presented to the Bank's satisfaction:

(i) the revised FHIS Operations Manual (paragraph 2.8), including operational guidelines for execution of the pilot initiatives (paragraph 2.14); (ii) the agreement signed by the FHIS and the Ministry of Finance for the transfer of: (a) maintenance incentives (paragraph 2.24) and (b) the program funds (paragraph 3.41); (iii) the agreement that the FHIS has presented to the Ministry of Natural Resources and the Environment (SERNA) for its signature, that includes the creation—where they do not exist—of new municipal environmental units in the DOPC pilot municipalities (paragraph 2.33); (iv) the final selection of municipalities for the pilot initiatives (paragraph 2.13); (v) the agreement that the FHIS presented to the Association of Honduran Municipalities (AMHON) for signature, whereby AMHON undertakes to support participation of the chosen municipalities in the pilot projects (paragraph 3.27); and (vi) the model of the agreement to be signed by each municipality participating in the various pilot projects under the program, on the terms agreed upon with the Bank (paragraph 2.14).

Poverty-targeting and social sector classification:

This operation qualifies as a poverty targeted investment given that it supports the activities of a social investment fund (automatic sector classification) (paragraph 4.19). Moreover, because it involves the social sector, the operation qualifies as a social equity enhancing project as described in the indicative targets for the Bank's activities set out in the Eighth Replenishment report (document AB-1704).

Exceptions to Bank policy: None.

Procurement: Procurements under the program will conform to Bank policy. International competitive bidding will be required for construction contracts worth over US\$1,500,000, US\$250,000 for related goods and services, and US\$200,000 for consulting services

Procurement of goods, construction work, and services for which FHIS is responsible and which fall below the above thresholds will be governed by the FHIS Procurement Operations Manual (paragraph 3.37).

Procurement method	Construction	Goods	Consulting services
International competitive bidding	1,500,000 or more	250,000 or more	Over 200,000
Local competitive bidding	75,000 to 1,499,000	75,000 to 149,999	75,000 to 200,000
Limited bidding	37,000 to 74,999	37,000 to 74,999	37,000 to 74,999
Short list of providers	Under 37,000	Under 37,000	Under 37,000

Procurement of goods, works, and services for which the municipalities are responsible will be governed by Honduran legislation provided that it does not contravene the Bank's basic principles.

POVERTY REDUCTION AND LOCAL DEVELOPMENT PROGRAM – PHASE II (HO-0220)

Narrative Summary	Verifiable Indicators	Means of Verification	Relevant Assumptions
Goal			
Support implementation of the poverty reduction strategy in Honduras.	<ol style="list-style-type: none"> 1. Poverty index. 2. Increase in average educational attainment. 3. Decline in Infant undernutrition. 	<ol style="list-style-type: none"> a. Annual report on PRS implementation. 	Honduras reaches agreement with the IMF and receives debt relief.
Purpose			
Give the poor greater access to high quality, sustainable basic social services.	<ol style="list-style-type: none"> 1. US\$22 million in projects are financed during the 3 years of the program in the education, health care, water and sanitation, environmental and municipal sectors. 2. 90% of projects executed under centralized and decentralized models receive a satisfactory quality rating. 3. Index of unmet basic needs declines. 4. School enrollment rises. 5. Basic social services coverage expands (by poverty category) <ol style="list-style-type: none"> a. education b. health care c. water and sanitation 6. 80% of beneficiary households consider satisfactory the facilities or the quality of the works that deliver basic social services to them. 	<ol style="list-style-type: none"> a. INE statistics. b. Data from Living Standards Measurement Surveys. c. Beneficiary satisfaction survey. d. FHIS semiannual reports. 	<ol style="list-style-type: none"> a. An enabling political and economic environment. b. Public spending on social sectors rises to meet PRS targets.
Components			
1. Execute and operate investments in social infrastructure (on a participatory basis)	<ol style="list-style-type: none"> 1.1 100% of financed investments are included in municipal investment plans. 	<ol style="list-style-type: none"> a. FHIS semiannual reports. b. COF/CHO inspection visits. c. Midterm review. 	

Narrative Summary	Verifiable Indicators	Means of Verification	Relevant Assumptions
	<p>1.2 90% of completed projects are operating at program end</p> <p>1.3 100% of projects have 3 social auditors during program execution.</p> <p>1.4 Formal commitments to community contribution and sustainability for each project.</p> <p>1.5 A works maintenance organization is set up and active on each funded project.</p> <p>1.6 Community training provided under each executed project.</p> <p>1.7 The number of municipios participating in operational delegation of the FHIS project cycle increases from 21 in the base year, to 40 in the year of program execution.</p> <p>1.8 All approved projects undergo ex ante cost-benefit or cost-effectiveness analysis, and are economically feasible.</p>	<p>d. Final evaluation of the program.</p> <p>e. Audit report.</p>	
<p>2. Execute plan to improve municipal and local management.</p>	<p>2.1 A minimum of 15 municipios increase their locally generated revenues by 5% per year (in real terms).</p> <p>2.2 A minimum of 15 municipios increase their investments by the same amount as their increase in locally generated revenues.</p> <p>2.3 A minimum of 15 municipios succeed in recovering costs.</p> <p>2.4 A minimum of 15 municipios have an environmental management plan approved by the municipal council.</p>	<p>a. Reports based on the PATMUNI monitoring system.</p> <p>b. Evaluation report on the Innovation Program.</p>	<p>The SGJ and municipios enter into framework agreements.</p> <p>The SGJ develops the municipal financial management and tax administration system on schedule.</p>

Narrative Summary	Verifiable Indicators	Means of Verification	Relevant Assumptions
	<p>2.5 A minimum of 15 municipios have municipal development master plans.</p> <p>2.6 A minimum of 15 municipios have 3-year investment plans</p> <p>2.7 A minimum of 15 municipios have a working financial management and tax administration system.</p> <p>2.8 Municipios submit a minimum of 60 proposals for the use of funds awarded by competition.</p> <p>2.9 A minimum of 15 innovation projects are executed successfully.</p> <p>2.10 Good practices are disseminated through the media and publications.</p>		
<p>3. Strengthen the institutional framework for local development.</p>	<p>FHIS</p> <p>a1. 12 months into the program, 100% of FHIS restructuring plans have been executed satisfactorily, and performance indicators show improved operational performance improves for the FHIS overall and for each of its individual offices/departments.</p> <p>a2. 24 months into the program, 90% of institutional strengthening and training activities are complete, and project cycle execution is demonstrably more efficient.</p> <p>a3. 24 months into the program, overhead costs have fallen from 22.26% to 14%.</p>	<p>a. FHIS and auditors' semiannual reports</p> <p>b. Reports on consulting assignments.</p> <p>c. Key institutional performance indicators</p> <p>d. COF/CHO inspection visits to FHIS and field visits.</p> <p>e. Chief technical advisor's project performance monitoring report on institutional progress, technology development, and quality of projects under centralized and decentralized models.</p>	<p>a. Political will to carry out FHIS reforms.</p>

Narrative Summary	Verifiable Indicators	Means of Verification	Relevant Assumptions
	<p>a4. 24 months into the program, 100% of projects under the centralized model have implemented the policies and procedures of the General Operations Manual.</p> <p>a5. 36 months into the program, 100% of projects under the decentralized model have implemented the policies and procedures of the General Operations Manual.</p>		
	<p>SGJ</p> <p>b1. The SGJ performs its standard-setting, regulatory and evaluation functions exclusively by program end.</p> <p>b2. 24 months into the program, consensus has been achieved on a clearly defined decentralization policy.</p> <p>b3. An interagency coordination mechanism is up and running by the end of the first program year.</p> <p>b4. By the end of the first program year, a single decentralization monitoring and evaluation system is in place with stakeholder consensus.</p> <p>b5. By program end, consensus has been reached on a single national policy on municipal training, and such a policy has been approved.</p>	<p>a. Final evaluation of the program.</p> <p>b. CECE minutes approving the decentralization policy.</p> <p>c. CECE minutes approving the municipal training and technical assistance strategy.</p> <p>d. Semiannual reports based on the decentralization monitoring and evaluation system.</p>	<p>a. The SGJ is backed by the public, private, and nongovernmental sectors.</p> <p>b. The SGJ sets the necessary rules and regulations to guide and promote the decentralization process.</p>
Activities			

Preliminary Procurement Plan
(in thousands of U.S. dollars)

Major Purchases	Totals (*)	Financing		Method	Prequal.	Expected Publication Date
		% IDB	% Local			
<u>Works</u>						
- Social investment	22,177	99%	1%	LCB, RB, DC	No	I/2004 – IV/2006
<u>Consulting services</u>						
Technical assistance						
- Social investment	200	100%	10%	LCB, RB	No	I/2004 – IV/2006
- Strengthening the SGJ	1,650	90%	10%	RB, LCB, ICB	No	I/2004 – IV/2006
- Modernization of the FHIS	200	90%	10%	RB, LCB, ICB	No	I/2004 – IV/2006
- Evaluation	350	100%		LCB	No	II/2005 y IV/2006
Training						
- Social investment	1,559	100%	7%	RB, LCB	No	I/2004 - IV/2006
- Municipal management	6,750	93%	5%	ICB, LCB	No	I/2004 – IV/2004
- Modernization of the FHIS	89	95%	10%	LCB, RB	No	I/2004 - IV/2006
Project management firm	766	90%	10%	ICB	Yes	IV/2003
Hardware						
Computers and printers						
- Modernization of the FHIS	120	95%	5%	LCB, RB	No	I/2004 – IV/2005
- Strengthening the SGJ	180	90%	10%	LCB, RB	No	1/2004 – IV/2005
Totals	<u>34,041</u>					

* Total value of major purchases during the three years of program phase II.